No. 14913

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

[illegible] Pipe & Supply Company, a corporation,

Appellant,

vs.

[illegible] Trustee in Bankruptcy of James T. [illegible],

Appellee.

BRIEF FOR APPELLANT

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

KEENAN PIPE & SUPPLY COMPANY, a corporation,

Appellant,

vs.

B. E. SHIELDS, as Trustee in Bankruptcy of James T. Inman,

Appellee.

BRIEF FOR APPELLANT.

Statement as to Jurisdiction.

Appellee B. E. Shields, as Trustee in Bankruptcy of James T. Inman, Bankrupt, commenced this action in the District Court of the United States in and for the Southern District of California, Northern Division, against appellant Keenan Pipe & Supply Company, a California corporation, to set aside an alleged voidable preference and to recover from appellant the sum of $9,223.03 which had been paid to appellant with interest and costs of suit [T. R. 3-4].

Appellant filed its answer acknowledging the receipt of said moneys but denied the alleged preference and by separate defenses alleged that said moneys were received by it in satisfaction of its materialman's liens [T. R. 5-9].

Judgment was entered on July 12, 1955, in favor of appellee and against appellant in the sum of $6,185.64 principal, interest in the sum of $541.24 and costs of suit in the sum of $68.30 [T. R. 12]. Appellant's Notice of Appeal was timely filed on August 2, 1955 [T. R. 13] and an Undertaking for Cost Bond on Appeal was filed on August 11, 1955.

The District Court had jurisdiction under Section 60(b) of the Bankruptcy Act (11 U. S. C. A., Sec. 96(b)). This Court has jurisdiction under Section 1291 of the United States Code of Judiciary and Judicial Procedure (28 U. S. C. A., Sec. 1291). See also Section 24 of the Act Relating to Bankruptcy (11 U. S. C. A., Sec. 47).

Statement of the Case.

James T. Inman filed his voluntary petition in bankruptcy on October 17, 1953 [T. R. 17, 20]; that for several years prior thereto the bankrupt had engaged in his trade as a licensed plumber.

That along with plumbing work done for other persons, the bankrupt had done certain plumbing sub-contract work for one John H. Deeter, General Contractor [T. R. 68], and had purchased plumbing materials and supplies for such work from Keenan Pipe & Supply Company, dealer in plumbing materials and supplies [T. R. 20].

That during the time here in question the work done for Deeter by Inman fell into two categories:

1. Subcontract work on the California State Epileptic Hospital at Porterville, California [T. R. 21], original contract for $11,300.00 and

2. Subcontract work on private residences [T. R. 78].

In addition to said sub-contract work on the California State Epileptic Hospital at Porterville, California, Inman had a separate contract with the State of California for "change orders" and "extra work" done by him as a licensed plumber on said California State Epileptic Hospital at Porterville, California, for which Inman filed a claim with the State of California for approximately $12,000.00, which was reduced approximately $2,000.00 before payment [T. R. 81].

During the course of the work on the State Porterville job and prior to the delivery of the materials and supplies by Keenan, and beyond the four month period, Inman had an oral understanding with Keenan and Deeter to the effect that Keenan would carry for Inman the cost of the materials and supplies and Deeter would carry the cost of the labor for said job until payment was received from the State of California upon completion of the job and that said sums would be payable therefrom [T. R. 81, 83].

That as of July 8, 1953 said State Porterville job had been completed but final payment therefor had not been made by the State of California, and there was due from Inman to Keenan $13,306.08, of which amount the sum of $5,416.63 was due for materials and supplies furnished to said State Porterville job, which latter sum was paid on July 8, 1953 by Deeter to Keenan by way of a joint check dated August 9, 1953 payable to Inman and Keenan, and which check was endorsed by Inman and his wife and then deposited to the account of Keenan. At the time of this payment to Keenan, Keenan was entitled to file "Stop Notices" in accordance with Section 1190.1 of the California Code of Civil Procedure [T. R. 72, 73, 79, 85].

That as of September 4, 1953, there was due from Inman to Keenan on account of plumbing materials and supplies $7,928.90, of which amount the sum of $769.01 was due for materials and supplies furnished for the construction of private residences being built by Deeter as general contractor [T. R. 78], which sum was on that date paid by the check of Deeter directly to Keenan. At the time of this payment said residences were subject to the lien of Keenan for such materials and supplies and the time within which Keenan could have filed claims of lien to cover same in accordance with Section 1193.1 of the California Code of Civil Procedure had not expired [T. R. 79].

That at the time of the payment of said $5,416.63 and said $769.01 said State Porterville job had been completed, but final payment therefor had not been made by the State of California [T. R. 84] and there was then due Inman the 10% withhold on his original contract, or $1,000.00 [T. R. 81] plus the amount of his claim for "change orders", approximately $10,000.00 net [T. R. 81]. That Deeter paid said $5,416.63 and said $769.01 to Keenan (1) to prevent Keenan from filing a "stop notice" on the State Porterville job and "claims of lien" on the private residences [T. R. 85], and (2) because he knew Inman would have enough out of the State Porterville job to reimburse him for these amounts.

That Inman's financial condition was substantially the same when each of the checks in question were paid to Keenan; that at such times he had assets variously valued by Inman and his wife from $15,000.00 to $30,000.00, among which were the following:

1. 10% retention on original subcontract on California Porterville job, $1,000.00 [T. R. 81]

2. "Extra work" and "change orders" on the California Porterville job, original claimed approximately $12,000.00 later reduced approximately $2,000.00 $10,000.00 [T. R. 81]
3. Personal residence, valued and listed for sale at $15,000.00, subject to $11,000.00 encumbrance $4,000.00 [T. R. 47]
4. Three motor vehicles, 1940 International 1½ ton truck, 1949 Pick-up truck, 1947 Packard Sedan, valued at $1,000.00 to $1,200.00, subject to no liens $1,200.00 [T. R. 55]
5. Stock in trade, valued at $3,000.00 [T. R. 25]
6. Tools, valued at $1,000.00 to $1,500.00
7. Farming equipment, valued at $1,000.00 to $1,-200.00 [T. R. 45], on which $900.00 was owed
8. Due on other contracts, requiring $3,200.00 additional plumbing materials to complete, recoverable amount to Inman not being established, value unknown [T. R. 33].

That at the time of said payments Inman's liabilities were approximately $20,000.00, of which $4,629.94 was for taxes.

That prior to the payment to Keenan of said two checks, Inman experienced difficulty "in getting his hands on money"; that Keenan's agent Keefe visited him regularly about once a week; that Keefe was friendly towards him; that Keefe asked him for payment on account and for a list of uncompleted jobs [T. R. 33]; that Inman and Keefe determined that it would take $3,200.00 additional plumbing materials and supplies to complete the uncompleted jobs [T. R. 33]; that Keefe assisted Inman in the preparation of his claim for extras on the State Porterville job.

Specification of Errors.

I. That Finding No. 5 "That payment of said sum ($6,185.64) resulted in a depletion of the estate of said James T. Inman" is not supported by the evidence. (Parenthetical material added.)

II. That Finding No. 6 "That at the time of the payment of each of the sums totaling $6,185.64, the said James T. Inman was insolvent" is not supported by the evidence.

III. That Finding No. 7 "That at the time of said payment defendant had reasonable cause to believe that said James T. Inman was insolvent" is not supported by the evidence.

IV. That Finding No. 8 "That as a result of the payments aforesaid, defendant was enabled to obtain a greater percentage of his debt than some other creditor of the same class" is not supported by the evidence.

V. That Conclusion of Law No. 1 "The subject transfer of $6,185.64 constitutes a voidable preference under Section 60 of the Act Relating to Bankruptcy" is not supported by the evidence or the Findings of Fact and is contrary to law.

VI. The Court in concluding that the payments to appellant were voidable preferences under Section 60 of the Act Relating to Bankruptcy held that payments to a holder of a materialman's lien during the existence of said lien were voidable preferences; and such holding

is contrary to the provisions of the laws of the State of California, of Section 67 of the Act Relating to Bankruptcy, and the court decisions applicable thereto.

Summary of Argument.

1. In a situation where in order to complete his contract a subcontractor arranges with his prime contractor and his materialman that the prime contractor would advance the money for labor costs and the materialman would supply the materials to complete the contract and that the prime contractor would be reimbursed for his advances, and the materialman paid, when funds were received from the public body; and where pursuant to such arrangement the materialman supplied the necessary materials and when the funds were received from public body the moneys due the materialman were paid to him by the prime contractor to extinguish the materialman's lien, such payment was not a voidable preference even though such payment was received within four months of bankruptcy.

2. The extinguishment of a materialman's lien by payment within four months of bankruptcy is not a voidable preference.

ARGUMENT.

I.

No Voidable Preference by Extinguishment of Lien.

In the case at bar the facts are not in serious dispute. The prime contractor, Deeter, had a contract with the State of California for the construction of certain facilities at the State Hospital for Epileptics at Porterville, California. The bankrupt, Inman, was the plumbing subcontractor on the job. Appellant, Keenan Pipe & Supply Company, sold and furnished plumbing materials and supplies to the bankrupt which materials and supplies were used in the construction of said facilities. After the main contract had been completed, the State of California issued some change orders for the bankrupt who undertook to perform the change orders. There were no progress payments on the change orders and it became necessary to make arrangements to carry the bankrupt. Keenan agreed to carry the material and Deeter agreed to carry the labor [T. R. 81]. After the work had been done and before the payment on the change orders had been received from the State of California, Deeter in order to prevent Keenan from filing a Stop Notice with the State of California issued on July 7, 1953 a postdated check payable jointly to the bankrupt and Keenan in the sum of $5,416.63 [T. R. 73]. This check was dated August 9, 1953 and paid by the bank on August 11, 1953. Approximately three weeks later Deeter issued a check dated September 4, 1953 payable to Keenan alone in the sum of $769.01 in order to prevent claims of lien from being recorded against private dwellings. These checks paid in part the bankrupt's obligation to Keenan. Keenan is still a general creditor of the bankrupt's as to the balance of the obligation due from the bankrupt.

These checks were received by Keenan in satisfaction of its liens for the materials furnished for and used by the bankrupt on the respective jobs.

As of the time of the payment of the aforesaid checks Keenan held liens upon the funds payable from the State of California and on the private dwellings. It had done all that was required of it by the laws of the State of California. If the liens had not been extinguished by the payment of the aforesaid sums, Keenan could have enforced its lien by filing what are commonly known in the profession as "Stop Notices" with the State of California and secured payment by such methods on the public improvement and by claims of lien recorded against the private dwellings.

The lien of Keenan is founded on Section 15, Article XX, of the Constitution of the State of California which provides as follows:

> "Mechanics, materialmen, artisans, and laborers of every class shall have a lien upon the property upon which they have bestowed labor or furnished materials, for the value of such labor done and materials furnished; and the legislature shall provide, by law, for the speedy and efficient enforcements of such liens."

It is to be noted that the Constitution establishes a lien and directs the Legislature to provide for the "speedy and efficient enforcement of such liens." In compliance with Constitutional directive the Legislature enacted appropriate legislation for the enforcements of said liens. Chapter II, Title IV of the Code of Civil Procedure of the State of California is the present enactment of the Mechanic's Lien Laws pursuant to said Constitutional directive.

Since Keenan had a lien for the plumbing materials and supplies furnished in the construction of the public work, to what property does Keenan's lien attach? Since the real property upon which the construction was done was public property, it is clear that the real property cannot become subject to the lien.

In the case of *Goldtree v. City of San Diego,* 8 Cal. App. 505, 97 Pac. 216, 8 Cal. App. 512, 97 Pac. 218, it was held that Section 1184 (now Sec. 1190.1) of the Code of Civil Procedure for giving notice of claim by notice to the holder of the fund earned by claimant's labor, and not that provided by Section 1183 (now Sec. 1193.1) of said code by recording against the property, applies where a lien is claimed for work done on a public improvement.

See also *Bates v. Santa Barbara County,* 90 Cal. 543, 27 Pac. 438.

In *Malott & Peterson v. Street* (9th Cir.), 4 F. 2d 770 (1920), the Court states:

> "Again, it (the materialman) might, in a proper case, serve notice on the owner to withhold, and pursue the remedy prescribed by Section 1184 (now Section 1190.1), and by doing so it might acquire a lien which would not be affected by the subsequent bankruptcy of the debtor." (Matters in parenthesis added.)

As above noted, before starting on the change orders, an agreement was reached between Inman, Deeter and Keenan wherein Keenan agreed to supply the materials and Deeter to furnish the payroll to enable Inman to do the change order work, all parties agreeing that no payments would be forthcoming until such time as the

change order work had been accepted by the State of California.

This situation is somewhat similar to the facts of the case of *United States Fidelity and Guaranty Co. v. Sweeney,* 80 F. 2d 235 (1935). In this case the debtor was a contractor on a highway construction contract in Missouri. The United States Fidelity and Guaranty Company furnished the completion bond on the contract. The contract provided that the State Highway Commission was to withhold certain percentages of the amounts due on progress payments until the work of improvement was accepted by the commission. Prior to executing the surety bonds United States Fidelity and Guaranty Co. required the contractor to assign to it the above reserve withholds and deposits. After work was commenced, it became evident that the contractor would default in the payment of labor and material. An agreement was then set up whereby a special account was opened with the Central Missouri Trust Company in which account all moneys were to be deposited. The Highway Commission was notified and thereafter made all payments due on account of said contract into this special account. All accrued bills of the contractor were to be paid by check of the contractor drawn against this account and countersigned by United States Fidelity and Guaranty Co. This arrangement continued until the contractor was adjudicated a bankrupt. The money which was the basis for the action was the balance in said account as of the adjudication in bankruptcy, the contract having been completed and all moneys due from the Highway Commission had been paid. After bankruptcy, United States Fidelity and Guaranty Co. paid said funds out on labor and material bills. The trustee in bankruptcy

sought to recover the amount on hand as to the date of bankruptcy.

The court held that United States Fidelity and Guaranty Co. had an equitable lien on said deposits, saying:

> " 'As long as the percentages held back to secure performance of the contract can be identified and followed, they can and should be subjected in equity to the lien of the security.' 'Equitable liens, if created before the four months period before bankruptcy, are valid and enforceable against the trustee, and they are not preferential even though the funds upon which they are a charge are collected after adjudication in bankruptcy. *Voltz v. Treadway & Marlatt,* 59 Fed (2d) 643. If an equitable lien is created, it is immaterial that the formal ascertainment of the specific beneficiaries was made within four months of the bankruptcy proceedings.' (Citing *Johnson v. Root Mfg. Co.,* 241 U. S. 160.) 'We conclude that appellant (United States Fidelity and Guaranty Co.) had a valid equitable lien upon these funds which should be recognized and protected; *that its rights had their inception at the time it became surety for the construction company.*' " (Emphasis added.)

For a similar situation, reference is made to the case of *McCluer v. Heim Overly Realty Co.,* 71 F. 2d 100 (1934). In this action trustee sought to recover sum received by defendant pursuant to assignment and pledge of amounts receivable from construction contract. Defendant loaned bankrupt sums to be deposited on bid on two sewer contract bids. Thereafter, defendant went surety on bankrupt's performance bonds, but before doing so first obtained from bankrupt an assignment of all funds derived from said construction projects. After the construction was completed, a dispute arose between the

officials of Kansas City and the bankrupt over the estimate of the balance due the bankrupt. Thereafter suit was commenced by the bankrupt against the city and bankrupt, after discovering the original assignment had been lost, made a new assignment of all moneys due under the estimate to defendant. Shortly thereafter bankruptcy proceedings were commenced. The Court held the assignments to be timely and valid and not preferential in nature, saying:

> "Since the lien created by the pledge of February 10, 1927, was genuine and sufficient and created more than four months before filing of the bankruptcy petition, the endorsement of that lien by collection of the $54,177.50, within the four months period did not operate as a voidable preference."

In the case of *Stickney v. General Electric Co.,* 44 F. 2d 362, all parties agreed upon the segregation of money becoming due a contractor for the protection of one who was selling him property to go into the project. The contractor went into bankruptcy, but the Court held that the trustee was not entitled to a deposit made for the benefit of the seller of property which went into the project. In the instant case the parties agreed that in order to carry Inman, Deeter would meet the payroll and Keenan the materials and although the record is silent thereon it may be inferred that the parties further agreed that upon receipt of the moneys from the State of California Deeter would reimburse himself for the payroll which he had paid out which he did [T. R. 82] and that Deeter would pay Keenan on behalf of Inman for the materials supplied by Keenan. If such an inference cannot be made there would be no basis for Keenan continuing to furnish materials to Inman.

The case of *Johnson v. Root Mfg. Co.,* 241 U. S. 160, is authority for the principle that payment of lienable claims within four months of bankruptcy does not create a voidable preference.

See also 6 *American Jurisprudence, Bankruptcy,* Section 1085.

Thus, the courts have held payment of a debt secured by a lien, legal, statutory, equitable or inchoate, which lien attached prior to the preferential period could be paid within four months of bankruptcy without creating a voidable preference.

In the case of *Jackson v. Flohr,* 119 Fed. Supp. 305 (U. S. D. C. W. D. Wash.), the facts were: In this case payments were made to the materialmen by check made payable to the materialman and the contractor. The court said:

> "By the express terms of Section 107, sub. (b) a mechanic's lien can be completed and enforced after bankruptcy adjudication without effecting a preference. If so, it surely could not have been the legislative intent that an unlawful preference result from satisfaction of a fully valid inchoate lien through payment of the debt secured by the lien prior to adjudication."

The court further stated:

> "Plaintiff strenuously insists that the bankrupt's estate was depleted by the payments in question. *If it be considered that the Bankruptcy Act by giving a lawful preference to the lien of a materialman, in effect earmarks funds in the hands of the owner for payment of the materialman, either by perfection and foreclosure of the lien or by discharge of the lien or by discharge of the lien through payment, no*

actual depletion occurs. (Emphasis added.) Congress certainly had the power to authorize preferences to materialmen and to make them dependent upon state law. There can be no doubt that Washington law extends a preference to materialmen and that the only condition thereof within the ninety day period is the giving of the five day notice. *Defendants in the instant case up to the time of receiving payment of their accounts had done everything required by state law to establish their status as lienors.* (Emphasis added.) Both letter and spirit of the Bankruptcy Act and the state lien law dictate that defendants should have the preference intended for materialmen.

"In the *San Mateo* case California transactions and California law applicable to materialmen's liens were involved. Presumably neither *Seattle Association of Credit Men vs. Daniels, supra,* nor any other Washington decision was cited or considered. The opinion does not cite any California decisions as controlling and independent research indicates that there are none. Inasmuch as Washington authority inferentially if not directly in point is available, the San Mateo decision is not controlling. Moreover, from the recital at page 876 of the opinion concerning the contentions made in that case, neither question presented and decided was identical with the precise lien question for decision in the present case. The First contention in the San Mateo case that release of an inchoate lien resulting from payment constitutes a present consideration for the payment is not urged by defendants in this case, and the Second contention is inapplicable to the facts now under consideration."

II.

Obligation Paid Was Not an Antecedent Debt.

It is the further contention of appellant that since appellant Keenan, Inman and Deeter in March 1953, entered into a parol agreement that in order to enable Inman to carry out the change order work, Deeter would carry the payroll and Keenan would furnish the materials and all parties agreeing that no payments could be made before the job was completed and accepted by the State of California, the payment of the obligation of $5,416.63 to Keenan would not mature until the work had been accepted by the State of California and if this be true, then the payments to Keenan was not the payment of an antecedent debt as provided in Section 60(a) of the Act Relating to Bankruptcy.

III.

Finding of Insolvency Not Supported by the Evidence.

It is a further contention of appellant that the evidence does not support the finding that Inman was insolvent at the time Deeter made the payments here involved. The testimony of Inman and his wife is so uncertain, vague and indefinite that it cannot support any finding as to their financial condition as of the time of the payments to Keenan by Deeter.

Appellant also contends that the evidence does not support the Finding No. 6 that appellant had reason to believe that Inman was insolvent when the payments were received from Deeter. The testimony of both Mr. and Mrs. Inman indicate that although they were experiencing some difficulty, they believed that once they received payment on the change order work they would be able to straighten their affairs out.

Appellant has perfected this appeal with full cognizance of the opinion of this Court in the case of *San Mateo Feed & Fuel Co. v. Hayward,* 149 F. 2d 875. Appellant, however, contends that although said decision deals with a question similar to that in the instant case, the factual situation of the two cases are different in several important respects, as to the payments on the State of California property, which are:

1. The work of improvement in the present case was of a public nature and the lien attached to the funds payable from the State of California while in the San Mateo case the work was presumably on private property;

2. There was an agreement between contractor, subcontractor and materialman for the furnishing of payroll and materials for the job and reimbursement for the same in the instant case while the reported decision in the San Mateo case does not indicate any such agreement; and

3. There was no issue as to antecedent debt in the San Mateo case while in the instant case the question of antecedent debt must be determined. In view of the foregoing it is the contention of appellant that this court is not obliged to follow the San Mateo case on the theory of *stare decisis* or otherwise.

Appellant contends insofar as the extinguishment of the liens on the private dwellings by the payment by Deeter to Keenan of the sum of $769.01, that this case is also dissimilar to the San Mateo case as it was a direct payment by Deeter to Keenan and was not by way of a check payable jointly to Keenan and Inman. It should be noted that Deeter was the general contractor on the private dwelling jobs as well as on the State of Cali-

fornia work. If any person depleted the bankrupt's estate it was the general contractor Deeter not Keenan. The reasoning of *Jackson v. Flohr, supra,* seems to be particularly pertinent as it pertains to the payment of the lien on the private dwellings herein involved.

To treat the problem in another light we have here a situation where the lien of the Keenan Pipe & Supply Co. attached the moment that building materials and supplies were delivered by Keenan for and went into the job. The record fully substantiates the position that all of the material furnished by Keenan to Inman went in the particular jobs. This being the case an actual and subsisting lien obtained for the reasonable value of those materials supplied to that job until the same were paid for. This being true this lien continued until (1) it could be extinguished, or (2) lost by failure on the part of Keenan to take steps to enforce the payment of the lien. Taking the first in order, extinguishment, it could be extinguished (1) by a waiver of Keenan of its rights by an instrument in writing, or (2) by payment of the amount due under the lien by either the general contractor, the owner, or the subcontractor. In this particular case it was paid by the general contractor prior to his receipt of the moneys due from the State of California. Under the California law it was not necessary to perfect a lien. The lien was in existence and fully enforceable at the time the payments were made by Deeter to Keenan. The only thing remaining to be done should Keenan be unpaid and desire to enforce its lien would be to either give a stop notice where required on public buildings, or by recording its claim of lien on private properties. These procedures, of course, do not establish a lien, they are merely acts of procedure in foreclosing the same.

The *San Mateo* case (*supra*) states that since the property subject to the lien was not the property of the bankrupt, therefore any payment of moneys to the lienor on the obligations of the bankrupt would be a voidable preference. This seems to overlook the fact that under state law and under Section 67 of the Act Relating to Bankruptcy lien claimants are put in a select position. The Act Relating to Bankruptcy provides, among other things, that even though a lien is created and is existing at the time of bankruptcy the lienor may go ahead with procedural steps to enforce payment of it. The San Mateo decision in effect says that the materialman cannot accept payment from the contractor or subcontractor and thereby extinguish existing liens without running the danger that within four mouths next succeeding the contractor, or subcontractor, may go bankrupt and a claim raised that the payment of the amounts due under a valid lien are voidable preferences. This seems to be entirely at variance with the Act Relating to Bankrupcy and the State lien laws. Under the present decision of the *San Mateo* case, in order to protect themselves materialmen or subcontractors, as the case may be, dare not accept payment of a valid lien in this state without running the danger above mentioned, but, on the other hand, must first, regardless of the inconvenience to the industry, or to the credit of the owner or contractor, file a claim of lien or a stop notice and thereafter obtain his payment from the owner or the public body, as the case may be. Practically, the ruling in the *San Mateo* case has worked a very definite burden on the construction industry, on the financing of many projects, and it is urged that the ruling of the *San Mateo* case should be expressly overruled by the decision of this Court.

Appellant respectfully submits that the judgment appealed from is erroneous and should be reversed with directions to enter judgment in favor of appellant with costs.

Respectfully submitted,

JOHN B. PETERMANN,

Attorney for Appellant.

MARK WATTERSON,

Of Counsel.